

Message Text

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ACTION EA-12

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FM AMEMBASSY KUALA LUMPUR

TO SECSTATE WASHDC 558

INFO AMEMBASSY BANGKOK

AMCONSUL HONG KONG

AMEMBASSY JAKARTA

AMEMBASSY MANILA

AMEMBASSY SINGAPORE

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HONG KONG FOR TREASURY REP SHARPE

E.O.11652: N/A

TAGS: EFIN, EGEN, ECRP, MY

SUBJECT: CERP 0200 - 1978 GOM BUDGET

1. SUMMARY: THE GOM HAS ANNOUNCED AN EXPANSIONARY BUDGET FOR 1978 THAT WILL UTILIZE PUBLIC EXPENDITURE AND FISCAL INCENTIVES TO THE PRIVATE SECTOR TO STIMULATE ECONOMIC GROWTH. SOCIAL SERVICES, DEVELOPMENT AND DEFENSE ARE AGAIN THE MAJOR SECTORS RECEIVING GOVERNMENT FUNDING. THE OVERALL IMPACT OF THE BUDGET WILL BE FAVORABLE ON THE MALAYSIAN ECONOMY. MANY LOCAL OBSERVERS HAVE TERMED IT AN "ELECTION BUDGET" BECAUSE OF ITS MILDNESS ON TAXPAYERS. END SUMMARY.

2. MINISTER OF FINANCE TENGKU RAZALEIGH HAMZAH HAS ANNOUNCED THAT THE GOM'S PROPOSED BUDGET FOR 1978 WILL TOTAL \$4,920

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MILLION (MADE UP OF \$3,223 MILLION IN OPERATING EXPENSES AND \$1,697 MILLION IN DEVELOPMENT EXPENSES), AN ALMOST 20 PERCENT INCREASE OVER ACTUAL EXPENDITURES IN 1977. THE BUDGET, WHICH IS CLEARLY EXPANSIONARY, IS DESIGNED TO STIMULATE FURTHER ECONOMIC GROWTH IN 1978 AND TO CATCH UP ON TARGETS FOR PRIVATE SECTOR GROWTH AS LAID DOWN IN THE THIRD MALAYSIA PLAN (TMP). LOCAL OBSERVERS HAVE TERMED IT AN "ELECTION BUDGET" BECAUSE

OF ITS MILD TAXATION TREATMENT AND RUMORS OF AN EARLY ELECTION IN 1978. THE BUDGET IS PRIMARILY DEVOTED TO SOCIAL SERVICES, DEVELOPMENT AND SECURITY. THE PERCENTAGE BREAKDOWN OF PROJECTED CONSOLIDATED EXPENDITURES IS AS FOLLOWS: DEFENSE 13.4 PERCENT, INTERNAL SECURITY (POLICE) 7.2 PERCENT, EDUCATION 20.6 PERCENT, HEALTH 5.6 PERCENT, OTHER SOCIAL SERVICES (INCLUDING WELFARE) 3.1 PERCENT, AGRICULTURE 8.4 PERCENT, COMMERCE-TRANSPORTATION- COMMUNICATIONS INFRASTRUCTURE 14.6 PERCENT, PUBLIC UTILITIES 2.4 PERCENT, GENERAL ADMINISTRATION 7.5 PERCENT, TRANSFER PAYMENTS 8.0 PERCENT, DEBT SERVICING 10 PERCENT AND PENSIONS AND GRATUITIES 1.7 PERCENT. THERE WERE NO SIGNIFICANT CHANGES IN PROPORTIONAL MAKEUP OF EXPENDITURES FROM 1977 TO 1978.

3. IN ADDITION TO INCREASED PUBLIC SECTOR EXPENDITURES THE GOM, AS ANNOUNCED IN THE BUDGET SPEECH, WILL BE UTILIZING OTHER FISCAL MEASURES TO STIMULATE THE ECONOMY. THE MEASURE DESIGNED TO BOOST INVESTMENT IN THE MANUFACTURING SECTOR WILL BE AN ACCELERATED DEPRECIATION SCHEME THAT WILL ALLOW ANY INVESTOR, IN ANY INDUSTRY, TO WRITE OFF AGAINST TAXES 80 PERCENT OF HIS INVESTMENT IN PLANT OR EQUIPMENT DURING THE FIRST TWO YEARS. THE BUDGET ALSO ANNOUNCES TAX RELIEF TO ENCOURAGE PRODUCTION AND REINVESTMENT IN PRIMARY COMMODITY PRODUCTION, I.E., RUBBER, OIL PALM AND TIN. OUR ANALYSIS OF THESE (COMMODITY) MEASURES FOLLOWS BY SEPTTEL.

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4. IN ANOTHER MOVE THE GOM HAS CUT IMPORT DUTIES ON LUXURY ITEMS SUCH AS CAMERAS AND JEWELRY FROM 25 PERCENT TO 20 PERCENT FOR THE EXPRESSED OBJECTIVE OF STIMULATING BUSINESS ACTIVITY. MOST LOCAL OBSERVERS SEE THIS AS MORE OF A POLITICAL THAN AN ECONOMIC MOVE AND SPECULATE IT IS DESIGNED TO BUY FAVOR WITH THE ELECTORATE. ANOTHER REASON BEHIND THIS MEASURE, ACCORDING TO A CENTRAL BANK SOURCE, IS TO INCREASE CONSUMPTION.

5. ON THE REVENUE SIDE OF THE BUDGET THE GOVERNMENT EXPECTS TO COLLECT \$3,328 MILLION IN TAXES AND OTHER REVENUES, LEAVING AN OVERALL DEFICIT OF \$1,592 MILLION. THE GOM PLANS TO FINANCE PART OF THIS BY BORROWING \$800 MILLION FROM DOMESTIC SOURCES AND \$280 FROM INTERNATIONAL SOURCES. BECAUSE OF EXPECTED DELAYS IN IMPLEMENTATION OF DEVELOPMENT EXPENDITURES THE GOM FEELS THAT THE FINANCING OF THE REST OF THE DEFICIT FOR 1978 CAN BE DEFERRED TO A LATER DATE.

6. COMMENT: THIS IS THE SECOND CONSECUTIVE YEAR THAT THE GOM HAS PUT FORWARD A VERY EXPANSIONARY BUDGET IN AN EFFORT TO STIMULATE ECONOMIC GROWTH AND REACH GOALS LAID

OUT IN THE TMP. WHILE THE GOVERNMENT'S EFFORTS, THROUGH PUBLIC SECTOR SPENDING, WILL HAVE AN IMPACT ON THE LOCAL ECONOMY THEY WILL NOT BE AS EXPANSIONARY AS IT WOULD FIRST APPEAR. THE GOM'S RECORD OF ACTUALLY SPENDING FUNDS ALLOCATED HAS BEEN SPOTTY AT BEST (ACCORDING TO GOM ESTIMATES THEY WILL ONLY SPEND 64 PERCENT OF THEIR DEVELOPMENT BUDGET IN 1977). FISCAL MEASURES, SUCH AS THE ACCELERATED DEPRECIATION PROGRAM, SHOULD HAVE A TENDENCY TO INCREASE LOCAL PRIVATE SECTOR INVESTMENT, PARTICULARLY IN REPLACEMENT OF OLD PLANTS AND EQUIPMENT, BUT THEIR EFFECTS WILL BE SOMEWHAT DILUTED BY THE WORLD ECONOMIC SITUATION AND OTHER GOM POLICIES, E.G., THE INDUSTRIAL COORDINATION ACT. THE OVERALL EFFECTS OF THE BUDGET WILL BE TO STIMULATE ECONOMIC GROWTH AND THE GOM WILL ACHIEVE MUCH OF THE GOALS IT IS SETTING FOR ITSELF.

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THE MILDNESS OF THE GO'S TAX PROPOSALS ON INDIVIDUALS AND FIRMS ALSO LENDS CREDENCE TO THE WIDELY HELD BELIEF THAT THE GOM IS CONTEMPLATING EARLY GENERAL ELECTIONS IN 1978 RATHER THAN WAITING FOR THE AUGUST 1979 DEADLINE FOR NATIONAL ELECTIONS. WE ARE ANALYZING THE EFFECT OF THE NEW BUDGET ON U.S. EXPORTS TO MALAYSIA AND WILL REPORT ON THIS BY SEPTTEL.

MILLER

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